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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

COMMISSIONERS**DOCKETED**

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

APR 20 2006

DOCKETED BY

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IN THE MATTER OF THE APPLICATION FOR
EMERGENCY INTERIM RATE RELIEF FOR
MIRACLE VALLEY WATER COMPANY, INC.,
COCHISE WATER COMPANY, HORSESHOE
RANCH WATER COMPANY, CRYSTAL WATER
COMPANY, MUSTANG WATER COMPANY,
SIERRA SUNSET WATER COMPANY AND
CORONADO ESTATES WATER COMPANY,
OWNED BY JOHNNY A. MCLAIN.

DOCKET NO. W-01646A-06-0010
W-01868A-06-0010
W-02235A-06-0010
W-02316A-06-0010
W-02230A-06-0010
W-01629A-06-0010
W-02240A-06-0010

DECISION NO. **68667****OPINION AND ORDER**

DATE OF PUBLIC COMMENT:

February 21, 2006

PLACE OF PUBLIC COMMENT:

Sierra Vista, Arizona

DATE OF HEARING:

February 28, 2006

PLACE OF HEARING:

Tucson, Arizona

ADMINISTRATIVE LAW JUDGE:

Jane L. Rodda

IN ATTENDANCE:

Kristin K. Mayes, Commissioner

APPEARANCES:

Timothy Edwards, Executive Director, Arizona
Small Utilities Association, Interim Manager for
the McLain Systems;

Stephen A. Cockrum, In propria persona,
Intervenor; and

Jason Gellman, Staff Attorney Legal Division,
on behalf of the Utilities Division of the Arizona
Corporation Commission.

BY THE COMMISSION:

* * * * *

Having considered the entire record herein and being fully advised in the premises, the
Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

1
2 1. On January 6, 2006, the Arizona Small Utilities Association of Arizona ("ASUA"),
3 interim manager for Miracle Valley Water Company, Inc. ("Miracle Valley"), Cochise Water Co.
4 ("Cochise"), Horseshoe Ranch Water Company ("Horseshoe Ranch"), Crystal Water Company
5 ("Crystal"), Mustang Water Company ("Mustang"), Coronado Estates Water Company ("Coronado
6 Estates"), and Sierra Sunset Water Company ("Sierra Sunset"), (collectively the "McLain Systems"
7 or "Systems"), filed an application for emergency rate relief for the McLain Systems.

8 2. The McLain Systems provide water utility service to approximately 1,300 customers
9 in Cochise County, Arizona.

10 3. The Commission granted intervention to Stephen Cockrum, a customer of the
11 Horseshoe Ranch system, on February 2, 2006.

12 4. By Procedural Order dated February 2, 2006, the matter was set for public comment
13 on February 21, 2006 in Sierra Vista, Arizona and for hearing on February 28, 2006, at the
14 Commission's offices in Tucson, Arizona.

15 5. On February 10, 2006, AUIA mailed notice of the hearing to all of its customers.
16 ASUA also caused the notice to be published in the local newspaper and emailed copies to those
17 customers who have provided an email address.

18 6. The Commission received several written comments and heard public comment from
19 approximately 24 customers in Sierra Vista on February 21, 2006. There are many different opinions
20 on the proposed rate increase, but the general consensus is that something needs to be done as soon as
21 possible to bring these systems into compliance and providing safe water and reliable water.

22 7. On February 7, 2006, Commission Utilities Division Staff ("Staff") filed a Staff
23 Report, recommending approval of the requested interim rate relief.

24 8. On September 16, 2003, the Commission issued Decision No. 66241, an Order to
25 Show Cause and Order for Interim Relief ("OSC") against the McLain Systems. The OSC was based
26 on ADEQ Notice of Violations ("NOVs") and a July 1, 2003 compliance report that identified
27 numerous and major deficiencies that caused the systems to be operated in violation of state law and
28 in a manner that endangered the public health, safety or welfare.

1 9. On October 23, 2003, Johnny and Linda McLain, the Respondents in the OSC action,
2 filed with the Commission a Notice of Bankruptcy, indicating that on July 30, 2003, McLain had
3 filed for relief under Title 11 of the United States Code, initiating a Chapter 13 proceeding.

4 10. Among others things, Decision No. 66241 authorized Staff to appoint an Interim
5 Manager for the McLain water systems. On May 17, 2004, the Bankruptcy Court granted limited
6 relief from the automatic stay, and found that the Commission had authority to appoint an interim
7 manager to ensure the safe and reasonable operation and management of the McLain Water Systems.
8 ASUA began operating the McLain Systems as interim manger in July 2004.

9 11. The Bankruptcy Court in *In re Johnny A. McLain, et al.*, Case No. 4-03-bk-04125-
10 TUC-EWH, approved an Asset Purchase Agreement that sets the value of the McLain Water Systems
11 at \$1,000,000, but provided that the price is subject to adjustment depending on the rate base value
12 established by the Commission. In Decision No. 68412 (January 23, 2006) the Commission
13 approved a reconstruction cost new value for the McLain Systems of \$696,752.

14 12. The McLain Systems are in serious disrepair. All of the systems have suffered from
15 numerous, and often lengthy outages. As reported in the recent rate base docket W-01646A-05-0506,
16 most of the wells were drilled originally as domestic wells which have small diameter casings and
17 were drilled to limited depths. The only systems with storage tanks and booster pumps are the
18 Cochise and Horseshoe Ranch systems; the other five systems rely on the well pump to pressurize the
19 system, which is very inefficient and causes the well pump to cycle on and off too often leading to
20 premature pump failure. Many of the pressure tanks are leaking at the welds and/or have patches
21 welded to them, which is a serious safety hazard. Many of the well sites are not fenced and none of
22 the wells are metered. A majority of the pipe installed is Poly Vinyl Chloride ("PVC") irrigation pipe
23 which is not appropriate for potable water systems. Some of the very old pipe is asbestos cement
24 pipe which is no longer manufactured or allowed for use. Much of the location of the piping is
25 unknown as no plans were drawn, and it appears that much of the distribution piping strays outside
26 the official CC&N boundaries. The Sierra Sunset system has no record of a CC&N and has no
27 customer meters. None of the McLain Water Systems are chlorinated, which is serious because the
28 poor condition of the systems makes them prone to microbial contamination. See Decision No.

68412 (January 23, 2006).

13. Because of their serious inadequacies, the Commission established a hook-up moratorium for the McLain Systems in Decision No. 68272 (November 8, 2005). That order indicates that the needed capital improvements to bring the Systems into compliance, and providing safe and reliable water, total between \$750,000 and \$1,250,000.

14. The McLain Systems have experienced negative cash flow since at least the time ASUA was appointed interim manager. For the nine-month period ending September 30, 2005, there was a negative cash flow of approximately \$30,000. Estimates for the year ended 2005 indicate the negative cash flow will be \$40,000. The accounts payable for the McLain Systems totaled approximately \$96,000 as of year end 2005.¹ Several vendors will no longer offer materials or services to ASUA because there has not been sufficient cash flow to pay them for past services. The inability to contract with local vendors has hampered ASUA's ability to make needed repairs in a timely and cost efficient manner. ASUA has forgone receipt of its interim management fees for several months.

15. Based on an estimated annual operating cash flow deficiency of almost \$40,000, a need to pay down an accounts payable of nearly \$100,000 as of year end 2005, and a need for \$50,000 for repairs in the next twelve months, ASUA estimated a need to increase cash flow by \$11,700 per month. ASUA requested a surcharge of \$9.00 per meter, calculated as follows:

	<u>Annual</u>	<u>Monthly</u>
Current Estimated Annual Operating Cash Shortfall	\$40,000	\$ 3,333
Amortization of Accounts Payable over 24 months	\$100,000	\$ 4,167
System Improvements for 12 months	\$ 50,000	<u>\$ 4,167</u>
		<u>\$ 11,667</u>
Current number of metered customers		<u>1,300</u>
Average cost per meter		<u>\$8.97</u>
Proposed Surcharge at \$9 per meter		\$11,709

¹ By the time of the hearing, the accounts payable had increased to approximately \$139,000.

16. Each of the McLain Systems has a separate rate structure:

<u>Company</u>	<u>Monthly Charge</u>	<u>Gallons included in minimum</u>	<u>Commodity charge per 1,000 gal.</u>
Cochise	\$20.00	2,000	\$3.00
Horseshoe	\$17.00	1,000	\$3.00
Miracle Valley	\$10.00	2,000	\$1.00
Crystal	\$12.00	2,000	\$2.25
Mustang	\$15.00	1,000	\$2.50
Coronado	\$12.00	2,000	\$2.25
Sierra Sunset	\$25.00 ²		

17. The McLain Systems do not have the ability to raise additional equity or borrow more funds to make necessary capital improvements.

18. According to Attorney General Opinion No. 71-17, interim or emergency rates are proper when either all or any one of the following conditions occur: when sudden change brings hardship to a Company; when the Company is insolvent; or when the condition of the Company is such that its ability to maintain service pending a formal rate determination is in serious doubt.

19. Staff recommends the Commission issue an Order:

(a) Finding that the McLain Systems' problems constitute an emergency;

(b) Finding that it is in the public interest to authorize the requested interim SIS of \$9.00 per meter;

(c) Allowing ASUA to charge the interim surcharge requested pending a determination of a permanent rate case proceeding;

(d) Granting any additional and further relief as the Commission deems appropriate;

(e) Requiring ASUA to maintain the books and records of the McLain Systems in accordance with the National Association of Regulatory Utility Commissioners' Uniform System of

² Sierra Sunset does not have customer meters and users are charged a flat rate each month. There are approximately 30 connections on the Sierra Sunset system.

1 Accounts, and maintaining separate books and records for each of the seven systems;

2 (f) Requiring ASUA to maintain a separate bank account in which it will deposit and
3 withdraw all funds received pursuant to the System Improvement Surcharge;

4 (g) Requiring ASUA to file monthly reports with Docket Control, in Docket W-
5 01642A-06-0010, as a compliance item in this matter, detailing how the System Improvement
6 Surcharge funds were spent, on which of the seven Systems the money was spent, and a report of the
7 remaining amounts due on accounts payable;

8 (h) Requiring that to the best of its ability, ASUA apply the SIS funds, on a pro rata
9 basis to each of the systems to correct water outages as they occur, pay debts to local vendors and
10 make system improvements;

11 (i) Requiring ASUA to post a form of security in the amount of \$10 to the Utilities
12 Division; and

13 (j) Requiring the filing of a general rate case no later than March 15, 2007, using a
14 2006 test year.

15 20. Intervenor Cockrum believes that given the different rate structures of the seven
16 systems, and consequently the different revenue contributions each makes to the consolidated system,
17 a uniform surcharge placed on every meter is not equitable. Mr. Cockrum advocated an alternate rate
18 proposal that established a uniform rate structure with a minimum monthly charge of \$17.00 per
19 meter with no gallons included in the monthly charge, and a commodity charge of \$2.25 per 1,000
20 gallons for usage from 1 to 9,999 gallons, \$2.50 per 1,000 gallons for usage from 10,000 to 49,999
21 gallons; \$3.00 per 1,000 gallons for usage between 50,000 and 74,999 gallons, and \$4.50 per 1,000
22 gallons for usage from 75,000 gallons and above.

23 21. Mr. Cockrum believes that the situation at Sierra Sunset with no meters is
24 unacceptable, and that the "Operator" should install at its own expense a meter to measure the output
25 of the well, divide all gallons pumped between the connections on the system, and charge the Sierra
26 Sunset customers based on his proposed rates.

27 22. Mr. Cockrum also recommends that the interim manager post on its website budgets
28 for each of the Systems and an accounting of amounts owed to vendors, a cash flow statement for

1 each system, a profit and loss statement for each system, and a detailed plan for repairs and upgrades.
2 Mr. Cockrum also recommends that the interim manager create and publish a newsletter.

3 23. Mr. Cockrum further recommends that the operator solicit participation in an "Audit
4 Committee" to be comprised of at least one consumer of each system, a representative of the
5 operator, and one or more representatives of the Commission and ADEQ. This proposed committee
6 would review the performance and operations of the water companies and offer suggestions or
7 recommendations to the operator in an effort to improve performance.

8 24. Mr. Cockrum recommends that the majority of new revenues derived from the
9 adjustments, if granted and approved, be devoted exclusively to infrastructure upgrades at the
10 individual water companies in an effort to reduce the possibility of outages.

11 25. In *Residential Utility Consumer Office v. Arizona Corp. Com'n* 199 Ariz. 588, 20 P.3d
12 1169 (Ct. App. 2001), the court agreed with the *Scates*³ court's approval of the circumstances in
13 which interim rates may be considered and approved by the Commission. "*Scates* follows the
14 Attorney General's conclusion that, while the Commission has broad authority when setting rates, the
15 interim rate-making authority is limited to circumstances in which (1) an emergency exists; (2) a
16 bond is posted by the utility guaranteeing a refund to customers if the interim rates paid are higher
17 than the final rates determined by the Commission; and (3) the Commission undertakes to determine
18 final rates after a valuation of the utility's property. 118 Ariz. At 535, 578 P.2d at 616 (following the
19 conclusion drawn in Op. Att'y Gen 71-17)."⁴

20 26. The McLain System's inability to pay debts as they come due, its bankruptcy, and its
21 need to make immediate system repairs to prevent future outages is an emergency as defined under
22 Arizona law.

23 27. Mr. Cockrum raises important issues of rate design equity that should be investigated
24 at the time of the permanent rate case. His proposed rates are not based on meeting a revenue
25 requirement and thus cannot be shown to provide adequate cash flow to meet the operating needs of
26 the McLain Systems. The surcharge, as proposed by ASUA and recommended by Staff is a more
27

28 ³ *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 578, P.2d 612.

⁴ *RUCO* at 591.

flexible way of recovering the cash flow deficiency until permanent rates can be established based on auditable operating records. Mr. Cockrum's recommendations aimed at keeping consumers informed, are well intentioned and understandable, but are likely to increase operating costs or take valuable management time away from correcting system inadequacies. The monthly reports filed by the interim manager pursuant to Staff's recommendations will be available to consumers via the Commission's website. Further, we encourage ASUA to keep the McLain System consumers informed to the best of its ability of planned improvements or scheduled outages through use of its website, email, or other means of communication.

28. Staff's recommendations above comply with the law concerning the Commission's ability to implement interim rates, and, we believe that a bond of \$10 is adequate under the circumstances of this case.

CONCLUSIONS OF LAW

1. The McLain Systems are public service corporations pursuant to Article XV of the Arizona Constitution and A.R.S. §§ 40-250 and 40-251.

2. The Commission has jurisdiction over the McLain Systems and the subject matter of the application.

3. Notice of the application was provided in accordance with the law.

4. The McLain Systems are facing an "emergency" within the definition set forth in Attorney General Opinion No. 71-17.

5. The emergency rate increase requested herein is just and reasonable on an interim basis and should be granted.

6. The recommendations set forth in Findings of Fact No. 19 are reasonable and should be adopted.

ORDER

IT IS THEREFORE ORDERED that Arizona Small Utilities Association shall file on or before April 28, 2006, a revised tariff that allows for a monthly interim surcharge of \$9.00 per meter or connection for Miracle Valley Water Company, Inc., Cochise Water Co., Horseshoe Ranch Water Company, Crystal Water Company, Mustang Water Company, Coronado Estates Water Company,

1 and Sierra Sunset Water Company.

2 IT IS FURTHER ORDERED that the surcharge approved herein shall be interim and subject
3 to refund pending resolution of a permanent rate case.

4 IT IS FURTHER ORDERED that the Arizona Small Utility Association, or the future owner
5 of the McLain Systems, shall file an application for a permanent rate increase no later than March 15,
6 2007, using a 2006 test year.

7 IT IS FURTHER ORDERED that the above rates and charges shall be effective for all service
8 provided on and after May 1, 2006.

9 IT IS FURTHER ORDERED that the Arizona Small Utility Association shall post a bond in
10 the amount of \$10 prior to the implementation of the interim surcharge.

11 IT IS FURTHER ORDERED that the Arizona Small Utility Association shall notify its
12 customers of the rates authorized herein and their effective date within 15 days of the effective date
13 of this Order.

14 IT IS FURTHER ORDERED that the Arizona Small Utility Association, and any future
15 owner of the McLain Systems, shall maintain the books and records of the McLain Systems in
16 accordance with the National Association of Regulatory Utility Commissioners' Uniform system of
17 Accounts, and shall maintain separate books and records for each of the seven systems.

18 IT IS FURTHER ORDERED that the Arizona Small Utility Association, and any future
19 owner of the McLain Systems, shall maintain a separate bank account in which it will deposit and
20 withdraw all funds received pursuant to its System Improvement Surcharge.

21 IT IS FURTHER ORDERED that the Arizona Small Utility Association, and any future
22 owner of the McLain Systems, shall file monthly reports with Docket Control, in Docket W-01642A-
23 06-0010, as a compliance item in this matter, detailing how the System Improvement Surcharge
24 funds were spent, on which of the seven Systems the money was spent, and a report on the remaining
25 amounts still due on accounts payable.

26 IT IS FURTHER ORDERED that the Arizona Small Utility Association, and any future
27 owner of the McLain Systems, shall to the best of its ability, apply the SIS funds, on a pro rata basis
28 to each of the systems to correct water outages as they occur, pay debts to local vendors and make

1 system improvements.

2 IT IS FURTHER ORDERED that the Utilities Division shall audit the SIS fund expenditures
3 on an annual basis and the results of the audit shall be filed with the Commission on April 1 of each
4 year, beginning April 1, 2007. The audit shall include an on-site visit to review records and
5 infrastructure.

6 IT IS FURTHER ORDERED that the Arizona Small Utility Association, or any future owner
7 of the McLain Systems, and Commission Staff shall work together to devise a priority list of system
8 improvements.

9 IT IS FURTHER ORDERED that Miracle Valley Water Company, Inc., Cochise Water Co.,
10 Horseshoe Ranch Water Company, Crystal Water Company, Mustang Water Company, Coronado
11 Estates Water Company, and Sierra Sunset Water Company shall annually file as part of its annual
12 report, an affidavit with the Utilities Division attesting that the companies are current in paying their
13 property taxes in Arizona.

14 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

15 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

16
17 *Jeffrey M. Hatch-Miller*
18 CHAIRMAN

William T. Miller
COMMISSIONER

19
20 *Mark L.*
COMMISSIONER

James L. Sloan
COMMISSIONER

John W. Lynn
COMMISSIONER

21
22 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
23 Director of the Arizona Corporation Commission, have
24 hereunto set my hand and caused the official seal of the
Commission to be affixed at the Capitol, in the City of Phoenix,
this 20th day of April, 2006.

25
26 *Brian C. McNeil*
BRIAN C. McNEIL
EXECUTIVE DIRECTOR

27 DISSENT _____

28 DISSENT _____

SERVICE LIST FOR:

MIRACLE VALLEY WATER COMPANY, INC.
COCHISE WATER CO.
HORSESHOE RANCH WATER COMPANY
CRYSTAL WATER COMPANY
MUSTANG WATER COMPANY
CORONADO ESTATES WATER COMPANY
SIERRA SUNSET WATER COMPANY

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Timothy A. Edward
Arizona Small Utilities Association
210 N. Central, Suite 6B
Avondale, Arizona 85323
Interim Manager for the McLain Systems

Steven L. Wene, Esq.
MOYES STOREY
1850 North Central Ave., #1100
Phoenix, AZ 85004

Stephen A. Cockrum
5328 Corral Drive
Hereford, Arizona 85615

Christopher Kempley, Chief Counsel
LEGAL DIVISION
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Ernest Johnson, Director
Utilities Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

